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THE JAPANESE ECONOMY IN 1983

Summary

While the United States entered 1983 rebounding from recession, and Europe at least tentatively began to recover, the outlook in Japan did not improve until the second half of the year. In fact, 1983 marked the first time since 1976 that economic growth in the United States actually outpaced Japan's. Exports continued to be the leading growth sector in Japan, with continued weak performances in most domestic areas dampening the country's imports.

In spite of disappointing growth, the government was unable to find a solution that would stimulate the economy. Although very low rates of inflation prevailed, Tokyo was constrained in its ability to further lower interest rates out of fear that this would only result in a depreciation of the yen against the dollar, exacerbating the already tense international scene. Fiscal policy was an equally thorny issue because of the continued commitment to reducing the size of the government deficit. In this environment, the government could only sit by and hope that the growth of exports would spill over into a broader rebound. While there were some signs of this by the end of the year, they were still uncertain.

GNP Growth

Preliminary statistics show Japan's real (inflation-adjusted) gross national product (GNP) grew at a 3.0 percent rate in 1983, down from 3.3

percent in 1982 (see attached table). In fact, the rate of growth has been slowing since 1979, when it hit 5.2 percent. Not that this result was a surprise. At the beginning of the year, the Organization for Economic Cooperation and Development (OECD) predicted a growth rate of 3.5 percent; the Japanese government forecast issued by the Economic Planning Agency (EPA) was 3.4 percent -- both more realistic estimates than in previous years. Japan could actually achieve the EPA forecast if growth in the first quarter of 1984 is high enough.

While the overall level of growth was closer to expectations, the pattern was not. The Japanese government had been hoping for an expansion of private domestic sectors, fed by 3.9 percent growth in personal consumption, a 2.6 percent contribution by the residential construction sector, and a 2.9 percent level of private nonresidential fixed investment. While these forecasts refer to the fiscal rather than the calendar year, the data available so far indicate that they were overly optimistic.

The EPA was even farther off the mark with its forecast that the current account in the balance of payments would show a $9 billion surplus. The actual figure came to $24 billion for the calendar year, a new record. In fact, actual growth was much more highly dependent on the external sector than had been anticipated, a development that the Japanese government was uneasy about but was unable or unwilling to alter.

Over the course of the year, GNP growth was quite uneven. With public works expenditures heavily loaded into the first half of the fiscal year, growth was higher in the second and third quarters than in the first or last. From only 0.7 percent (at an annualized real rate) in the January-March quarter, growth jumped to 4.5 percent in the second quarter and 6.2 percent in the third, before slipping to 3.1 percent in the October-December period.

Japan seems to be adjusting to slower growth. In January 1983, the Economic Council proposed steering a 3-4 percent growth rate for the five-year forecast. In August, the cabinet approved a new eight-year economic plan (FY 1983-FY 1990) calling for a 4 percent real GNP growth rate. This seems reasonable, although if the weakness in domestic sectors continues, the goal could be unattainable.

Personal Consumption -- Of all the sectors of the economy, consumer spending is by far the largest, accounting for close to 50 percent of GNP. Although a modest revival in spending was expected in 1983, it failed to materialize, and at 3.3 percent, real growth in consumer spending was only slightly above the overall rate of GNP growth for the year and below 1982's 4.2 percent expansion of consumer spending. Low wage increases were a significant factor in limiting the increase in spending. Wage settlements came in at around 4 percent--which for some industries amounted to the lowest rise in the entire postwar period.

According to government statistics, the income of all worker households rose only 3.2 percent. Regular wage income was up by close to 4 percent, but was pulled down by a small 1.2 percent increase in temporary and bonus income.

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With the continued slow growth, overtime hours did not increase, nor did corporate profits expand enough to justify big bonuses. The limited gains in income meant that disposable (after tax) income increased only 2.6 percent in 1983. Since these are nominal wage and income figures, even the very low rate of consumer price inflation for the year (1.9 percent) brings the real increase in disposable income to only 0.7 percent, far below the 3.0 percent increase in 1982. Only by reducing that portion of disposable income allocated to savings were consumers able to generate even the modest increase in consumer spending indicated in the national income data. Since the ratio of personal savings to personal disposable income has been extraordinarily high in Japan, a drop in savings could fuel a considerable expansion of consumer spending. Nevertheless, the motives for saving seemed relatively unchanged and only a modest reduction in savings occurred during the year.

Private Residential Construction -- The real value of private residential construction displayed an absolute drop of 4.7 percent in 1983, a worse performance than the 0.8 percent dip in the previous year. Always a changeable item, housing declined at annualized rates of 13.4 percent and 41.9 percent in the first two quarters of 1983, followed by large increases of 14.4 percent and 24.6 percent in the last two quarters.

Housing construction starts also declined by 0.8 percent during the year, again larger than the 0.5 percent drop in 1982. However, the fact that spending fell more sharply than starts suggests that the private sector was building smaller residential units, a theory confirmed by a larger contraction in the floor area of new construction than in the number of starts. One reason for this was the rise in the proportion of rental housing being built. With low wage increases hurting the consumer, the proportion of total housing starts accounted for by rental units rose from 22 percent in December 1982 to 32 percent in December 1983. This stands as strong evidence of the sluggish economy, particularly at a time when the baby boom generation ought to be swelling the ranks of first-time home owners. Difficulties were compounded by the availability of financing, which is in turn affected by the amount of credit supplied by the government-owned Housing Loan Corporation. New loans for 1983 showed a marginal increase of 1.0 percent for the year, though this was deceptive because the quarterly figures show a drop, so that new loans in the final quarter of 1983 were 10.3 percent below the corresponding quarter of the previous year. Since the Housing Loan Corporation provides about one-third of all mortgage credit in Japan, its role in stimulating or restraining housing construction is very significant.

Private Nonresidential Investment -- High and increasing investment in productive plant and equipment had been the mainspring of Japanese economic growth in the 1950s and 1960s. However, the slower growth of the 1970s and 1980s brought stagnant investment, and for 1983, private nonresidential fixed investment grew at a real rate of only 2.0 percent, well below the 3.5 percent increase of 1982. However, there was some room for optimism since the quarterly trend was upward. After a real 0.6 percent drop in investment in the first quarter, the April-June quarter turned in a 3.8 percent annualized increase, followed by larger increases of 7.0 percent in the third quarter and 7.8 percent in the fourth quarter. This was being interpreted in Japan as a strong sign that the domestic recovery was underway. Since domestic private

and government consumption had been so sluggish, the upturn in business investment seemed to be largely a result of the rise in exports, as evidenced by a 1.6 percent hike in the manufacturing operating rate -- a statistical measure somewhat analogous to the capacity utilization index in the United States. This measure had declined in the previous two years, and was still declining at the beginning of 1983. By the end of the year, though, it was rising sharply.

Change in Inventories -- This item in the national income accounts is always a very capricious, but nevertheless important indicator of economic activity. In 1983, inventories continued to decelerate sharply, with net inventory accumulation falling 69.3 percent from the previous year, compared to a drop of 1.6 percent in 1982. Japanese analysts had been waiting for a long time to see stocks bottom out, and there was some indication that this occurred after the first quarter of 1983; the increases were much larger in the remaining three quarters. As a result of the completion of inventory adjustment, industrial production rose a modest 3.6 percent for the year, compared to a miniscule 0.3 percent in 1982.

Government -- Of the two categories of government spending -- current expenditures and fixed investment -- neither provided much stimulus for the economy in 1983. Current expenditures rose 2.4 percent in real terms for the year, compared to 2.3 percent in 1982. Fixed investment expenditures, on the other hand, dipped 0.2 percent, compared to a 0.0 percent growth in the previous year. The trend clearly shows the impact of concentrating public works expenditures into the first half of the fiscal year. The final quarter of fiscal 1982 (January-March 1983) showed a real drop in government fixed investment at an 11.1 percent annualized rate, reflecting the fact that expenditures had been front-loaded in FY 1982 as well, leaving little to be spent by the final quarter. The start of the new fiscal year brought a jump of 21.6 percent, followed by a smaller 3.5 percent increase in July-September, and a 12.5 percent drop in October-December.

The front loading of expenditures was calculated to achieve two goals. First, there was some hope that a supplementary budget would be passed in the fall, increasing public works expenditures for the second half of the year. This did not materialize. Second, it was a way of juggling expenditures to give the appearance of a more expansive fiscal policy, although the private sector was not fooled.

External Sector -- Since the net external sector is the difference between exports and imports of goods and services, its movement can be much more volatile than the change in either of the two components. Given that caveat, the 27.4 percent real growth in 1983 was rapid, but not extremely high, since it has been known to change by as much as several hundred percent in a single year (over 600 percent in 1980, for example). It was, though, the fastest growing sector last year, and increased at a much higher rate than the 3.5 percent registered in 1982. Thus of the 3.0 percent overall real GNP growth, the net external sector accounted for 1.5 percentage points--far above Japanese expectations.

The growth in net exports was the result of a rather modest 4.8 percent export growth and a 4.7 percent drop in imports. With the volume of oil

imports down, the sluggish economy and the high prices of foreign products, it is surprising that exports did not grow more rapidly. Keep in mind that exports and imports can be measured in a variety of ways, and the data in the national income accounts is not the one most often used in describing international developments. However, the balance of payments and the customs clearance data all portray the same picture of a rapidly rising surplus.

Inflation

The brightest piece of news for Japan was the year's very low rate of inflation. Wholesale prices actually declined by 2.2 percent, while consumer prices increased by only 1.9 percent. The slide in wholesale prices was influenced by the change in import prices, since imports have a 12.4 percent weight in the total index. In 1983, import prices declined by 7.8 percent, reflecting the rise in the average value of the yen. In addition, the price of energy imports (petroleum, coal and natural gas) dropped by almost 12 percent, and wholesale prices of domestic products dropped by 0.7 percent. While falling prices of imported raw materials were certainly a factor in this development, slack domestic demand also curtailed upward price pressures.

Overall export prices also declined 6.0 percent, which meant that the appreciation of the yen late in 1982 had little impact on the 1983 price competitiveness of Japanese products. The fact that prices for exports fell more than domestic goods suggests that companies were holding the line on sales tags in order to maintain market share. The one exception was automobiles, where the voluntary export restraints allowed higher sticker prices. However, even here, transport equipment export prices slipped 0.7 percent.

With wholesale prices dropping, consumer prices held at a steady 1.9 percent increase for the year -- the best performance among OECD countries. Consumer prices registering the most rapid ascent were education (up 4.9 percent) and housing (up 3.0 percent). While even these increases were slight, the fact that housing continued to rise in price faster than other sectors is one explanation for sagging housing investment. Given the very low wage increases in the spring of 1983, income growth did not push up prices, nor would higher retail markups have stuck with income rising so little.

Monetary Policy

With inflation running at very low levels and the economy growing more weakly than in the previous year, a further easing of monetary policy to stimulate investment and durable goods consumption might have been a logical choice. In fact, the Bank of Japan (BOJ) discount rate was lowered in October, but this was the only policy move during the year. Behind the reluctance to provide greater monetary stimulus lay the fear of encouraging further capital outflow which would weaken the yen and increase Japanese export price competitiveness, thereby contributing to international trade tensions.

One way to look at the direct outcome of monetary policy is to measure the growth of money supply. The Japanese monetary authorities generally can keep money supply growth closer to the desired targets than the Federal Reserve through "window guidance" policies which control the amount of commercial bank lending. All measures of money supply show lower growth in 1983 than in 1982.

Using year-end comparisons, the increase in modified M1 plus CD (certificates of deposit) grew 6.4 percent in 1983, as compared to 7.8 percent in 1982. Similarly, M2 plus CD grew at 7.3 percent, as compared to the year-earlier 7.9 percent -- suggesting that if anything, there was less monetary stimulus in 1983 than in the previous year.

Interest rates in Japan are under more direct control than the quantity of money and are adjusted by altering the BOJ discount rate, which is analogous to the Federal Reserve discount rate in the United States. The discount rate had last been lowered in December 1981 and there were repeated calls for further cuts through 1982 and the spring of 1983. In fact, in order to persuade reluctant buyers, the government was forced to raise the issue rate of interest on its March offering of government bonds. (Interest rates on these bonds are set through negotiations with the syndicate of financial institutions rather than in an auction market).

Some interest rates were cut in the absence of a discount-rate drop, but not by large amounts. In January, the long-term prime rate was dropped by 0.2 percentage points (from 8.6 percent to 8.2 percent). While this is a decision made by the long-term credit banks, they are heavily influenced by the government. But most market-determined interest rates showed little movement. The interest rate on 10-year government bonds in the resale market (excluding those newly issued at negotiated interest rates to the syndicate) showed very little variation until late in the year, hovering just under 7.9 percent. The gensaki and call rates, two principal short-term financial instruments, also changed very little.

Finally, in September the monetary authorities cut the discount rate 0.5 percentage points because the yen rose against the dollar (from approximately Y246 to Y236) and then strengthened again in October (to Y232). As a result, long-term credit banks, trust companies and insurance firms cut the long-term prime lending rate again by 0.2 percentage points to 8.2 percent, and were followed by the Japan Development Bank, the People's Finance Corporation (which lends to small business) and the Small Business Finance Corporation. The short-term lending rate at commercial banks was also cut by 0.5 percentage points. Thus, the discount rate did have some effect on lowering interest rates, although the effect was limited.

Since the drop in interest rates was small, it seems to have had a very limited impact on the economy. On the other hand, by widening the disparity between Japanese and U.S. interest rates, it may have contributed to capital outflow. The value of the yen on foreign exchange markets did not weaken, but neither did it continue the upward drift against the dollar that had begun in September and October. On balance, the impact of monetary policy during the year was marginal at best.

Fiscal Policy

In the final analysis, the burden of stimulating the economy rested with fiscal policy. But here too, powerful constraints were at work. The Ministry of Finance, pointing to the size of the government deficit, submitted a budget for the fiscal year starting April 1983 that contained only a 1.4 percent increase in discretionary general account expenditures, demonstrating its determination to hold down government spending and reduce the deficit. However, more recent statistical data show an anticipated 6.9 percent increase in total general account expenditures for FY 1983, mainly because of rapidly

rising debt service costs amounting to 18.6 percent plus a transfer of funds to close out the books on FY 1981. The only areas allowed substantial increases were defense (up 7.3 percent), foreign aid (up 6.2 percent) and energy (up 6.9 percent), in response to a variety of domestic and international pressures.

Even so, it was expected that 26.5 percent of total spending would have to be deficit financed. While this was below the 30 percent level anticipated for FY 1982, it remained above the earlier hopes of the Finance Ministry. Keep in mind that all budgeted figures for expenditures and revenues are only forecasts and can vary from the revised figures released later in the year or from the final figures once the books are closed.

In the sense that a large portion of government spending was deficit financed, the budget was stimulative, but as compared to the previous year, there was little additional stimulus. Moreover, the government deficit should be seen in light of the overall balance of savings and investment in the economy. With the large surplus of private-sector savings over private-sector investment, the government must run a considerable deficit to absorb the difference. The government's response in 1983 was insufficient to do so, and the rise in the current-account surplus and capital outflow reflected the difference. In that sense the stimulative effect was not meaningful.

FY 1984 Budget Process -- Even before the FY 1983 budget was approved, the Ministry of Finance was shaping the development of future budgets. In February, it released a revised medium-term fiscal outlook (to FY 1986) which would entail a reduction of new bond issues every year by either one-third, one-fifth, or one-seventh. The object was to indicate what the limits would have to be on government spending if the deficits were to be reduced (given certain assumptions about the growth of tax revenues). The report showed the necessity of continued cuts in spending or increases in taxes to achieve even the lowest case (one-seventh) goal.

When the ministry began to consider the budget for FY 1984, it was clear that although the commitment to eliminate the deficit would continue, the magical year in which the budget would be balanced would have to be pushed back to FY 1990, with a planned Y1 trillion ($4.2 billion) reduction in new bond issues each year until that point, a weaker goal than in the medium-term outlook.

By summer, the effort to reduce the budget deficit was complicated by stronger demands for an income-tax cut. Faced with this political probability, the MOF announced that all budget requests (for non-personnel discretionary spending) from ministries and agencies should be 10 percent lower than in the existing budget, except defense, foreign aid, mandated personnel and pension payments, and spending on alternative energy programs. As a result of this pressure, agency budgets submitted in September increased total spending on areas other than debt service and revenue sharing by only 1.0 percent.

Administrative Reform -- An important feature of the fiscal policy process in Japan in the 1980s was the emergence of the administrative reform movement calling for more efficiency in government. The commission urged the government to reorganize and review existing administrative systems in order to reduce epxenditures, called for the elimination of the budget deficit without any major tax increases, and supported a proposal to hold the level of expenditures below the economic growth rate by establishing a ceiling on budget requests. It further recommended converting the three major government-owned

corporations (the Japanese National Railways, the Nippon Telegraph and Telephone Public Corp. and the Japan Tobacco and Salt Public Corp.) to private management. The concentration of personal savings in the postal savings system was also to be reexamined.

Of greater significance than the specific proposals, though, was the impact of the commission on general attitudes. Generally the private business sector in Japan endorsed more expansionary economic policies. Through the rubric of the administrative reform movement, however, this stance was reversed, with the business sector (or at least certain parts of it) fully supporting tight controls on government spending. The only bone of contention between the private sector and the government was whether increased taxes should be used to reduce deficits.

Economic Stimulus Package -- In June, an interagency panel was appointed to program a way to stimulate the economy without causing inflation or widening the deficit. On October 21, on the eve of President Reagan's trip to Tokyo, the package was finally released. Domestic growth was to be attained through an $8.1 billion spending program for disaster relief and an infusion of additional funds from the Housing Loan Corp. and the Japan Highway Public Corp. This fiscal stimulus was to be strengthened by an income-tax reduction and additional loans to private industry by the Japan Development Bank. The government was also to support expanded investment by electric power utilities. The package included the cut in the BOJ discount rate considered earlier. Absent from the package, however, was the investment tax credit desired by MITI but opposed by the Ministry of Finance. The announcement was mute on the question of where the funds would come from to finance the increase in spending. In the previous year, a similar exercise had merely shifted money from one account to another without increasing total spending at all. In any case, the national income statistics suggest that the package did nothing to influence the net impact of the government on economic growth. In the final quarter, government fixed investment spending slid an inflation-adjusted 12 percent (at an annualized rate).

While this move provided some fiscal stimulus for the economy, the results came too late in the year to show up. The changes also meant that the goal of reducing government deficits was set back once again, but from the standpoint of macroeconomic savings and investment flows, this was the correct policy to follow. These objectives were imperiled, however, by clashing recommendations from the government's advisory tax council to reduce the tax benefits on retirement allowance reserves and introduce a variety of indirect taxes on passenger cars, liquor, and new products like compact discs and video disc players. The net implication of these developments on fiscal policy in 1983 indicated little change in Japan's basic policy stance. The emphasis was still focused on reducing government deficits rather than stimulating domestic demand.

For further information, contact Edward Lincoln.

The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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Japan's Real Gross National Product at Constant Prices (1975 Prices)

(in billions of yen, seasonally adjusted, quarterly totals and rates of growth at annual rates)

	1982	1983	January-March 1983	April-June 1983	July-September 1983	October-December 1983
Gross National Product	Y203,908.2 (3.3%)	Y210,112.7 (3.0%)	Y206,423.9 (0.7%)	Y208,683.0 (4.5%)	Y211,856.1 (6.2%)	Y213,496.9 (3.1%)
Personal Consumption Spending	106,945.2 (4.2%)	110,510.8 (3.3%)	109,712.5 (3.0%)	109,915.3 (0.7%)	110,848.1 (3.4%)	111,433.3 (2.1%)
Private Residential Construction	10,685.1 (-0.8%)	10,182.0 (-4.7%)	10,969.5 (-13.4%)	9,577.3 (-41.9%)	9,904.1 (14.4%)	10,464.2 (24.6%)
Private Fixed Nonresidential Investment	35,122.8 (3.5%)	35,810.5 (2.0%)	35,070.6 (-0.6%)	35,400.2 (3.8%)	36,002.0 (7.0%)	36,685.8 (7.8%)
Change in Business Inventories	1,798.9 (-1.6%)	551.9 (-69.3%)	53.4 (*)	884.8 (*)	400.4 (*)	869.6 (*)
Government Current Expenditures	19,258.5 (2.3%)	19,725.2 (2.4%)	19,502.5 (2.0%)	19,622.4 (2.5%)	19,843.5 (4.6%)	19,945.2 (2.1%)
Government Fixed Investment	18,474.8 (0.0%)	18,435.4 (-0.2%)	17,875.3 (-11.1%)	18,768.8 (21.6%)	18,932.2 (3.5%)	18,375.2 (-12.3)
Change in Government Inventories	-333.6 (-14.8%)	-334.4 (-0.2%)	-291.3 (*)	-206.0 (*)	-165.6 (*)	-676.3 (*)
Net External Sector	11,956.6 (5.7%)	15,231.3 (27.4%)	13,531.5 (36.4%)	14,720.2 (40.0%)	16,091.4 (42.8%)	16,399.9 (7.9%)
Exports of Goods and Services and Factor Income Received	40,424.0 (3.5%)	42,357.0 (4.8%)	39,891.5 (-1.7%)	41,108.1 (12.8%)	43,292.3 (23.0%)	44,949.2 (16.2%)
Imports of Goods and Services and Factor Income Paid	28,467.4 (2.5%)	27,125.8 (-4.7%)	26,360.0 (-4.3%)	26,387.9 (0.4%)	27,200.9 (12.9%)	28,549.3 (21.4%)

*Cannot be calculated or meaningless.

Source: Economic Planning Agency

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